

6.4. The Case of Croatia*

Introduction

Some key characteristics of the legislation pertaining to the Pension Fund industry in Croatia are outlined below. Those characteristics may be used to compile the different foreign countries' approaches (instruments) in addressing the concrete risks we have identified (prioritised and generalised) in our report so far.

6.4.1. General Remarks: the Fund and the Company

Mandatory and voluntary supplementary pension insurance are both based upon individual capitalised savings. An Agency for Supervision of Pension Funds and Pension Insurance is established – the Agency grants licenses and supervises Pension Investment Funds and their governing Pension Management Companies.

The Pension Management Companies are joint-stock or limited-liability companies. Those are actually the Investment Fund Management Companies as defined in the Law on Investment Funds.

A Pension Fund is the open-end investment fund as defined in the Law on Investment Funds. A Fund is comprised of amounts of contributions made by Fund members plus amounts of the returns on investing the contributions. A Fund is owned by its members. A minimum number of members is required (80 thousand for mandatory, 2 thousand for voluntary funds in the third year of operation): if the number of members falls below the statutory minimum for three months, authorisation is to be revoked.

The only object of activity of the Companies must be the administration of Funds, their representation before third parties and activities related to carrying out pension management business. A Pension Company may establish and manage one Fund only.

The registered name of the Companies shall contain the name 'Pension Management Company': only licensed Companies may use such words in their registered names.

Each Pension Company shall be liable to Fund members for damages resulting from any failure to perform its obligations pertaining to the administration of the Fund.

6.4.2. Managers' Qualifications

A member of the Board of Management or Supervisory

Board of a Pension Company must satisfy the requirement of the Company Law, as well as the following special requirements:

- must have a degree,
- must have professional work experience in the field of banking, accountancy, insurance or financial services for at least five years.

6.4.3. Information Disclosure

A Fund shall no later than 31 March each year publish an information prospectus about the previous year. The information prospectus shall be made available for inspection by anyone who applies for membership in the Fund, as well as by the current Fund members.

The Pension Company shall at least once in every six months provide each Fund member with information about the assets standing to the member's account. Such information is to be provided upon request by the members too, a fee for that may be imposed which cannot exceed the cost of providing the statement.

At least once a year a Pension Company shall disclose information on the value and proportion of the Fund's assets invested in particular securities, including details of the issuers.

The Pension Companies also submit various kind of information to the Regulator: annually or at other intervals specified by the Regulator.

A Pension Company shall keep an archive of all documents and other records related to the Fund it manages.

6.4.4. Selling Practices

No one may offer any collateral benefits (cash incentives, gifts, etc.) to a person for the purpose of persuading him to become or remain a Fund member. No one may offer such benefits to a trade union or other collective entity for the purpose of inducing or rewarding that entity to persuade its members to join a particular Fund.

No one may make any claims or predictions relating to the future investment performance of a Fund.

6.4.5. The Licensing Stage

'Authorisation' by the Regulator is needed prior to establishing a Pension Company. A separate 'license' is needed by the Regulator prior to undertaking the administration of a Fund. The register of trade cannot register a Pension Company until it has been granted that separate license. Once

* Chapter 6.4 was based mainly on material provided by Ivaylo Nikolov, the Center for the Study of Democracy.

authorisation is granted, incorporating the Pension Company is obligatory within six months. Authorisation to incorporate a Pension Company does not guarantee a license to carry on Fund management.

While reviewing the authorisation application procedure, the Regulator may cooperate with other competent regulatory authorities.

Within thirty days after incorporation, the Pension Company must submit an application for a license. If a license is granted, the Pension Company may commence the business of managing a Fund no earlier than the date of the issue of the license.

Any subsequent changes in the documents or the information submitted when applying for a license, require a prior approval by the Regulator.

An authorisation of functioning of a Pension Fund is also required: application for it should be made by the managing Pension Company at the same time as the Company itself applies for a license. The Regulator co-operates with other competent authorities while reviewing the application.

The Fund may contract a custodian or an external asset manager, and may start accepting contributions, only after authorisation for the functioning of the Fund and a license for the governing Company are granted.

6.4.6. Investing the Company's and the Fund's Assets

A Pension Company may not grant loans or provide guarantees. It may not borrow or take credits, including the issue of bonds, with a total value in excess of a percentage of the value of its own capital, as determined by the Regulator.

A Pension Company may acquire part or all of the share capital of another Pension Company with the prior consent of the Regulator.

The assets of the Fund are invested according to the principles of security, diversity and liquidity. A 'statement of investment principles' is drawn up in advance by the Supervisory Board of the Company. That statement is regularly reviewed and amended, as well as disclosed.

Fund's assets may only be invested in particularly specified by law classes of securities. Amongst those are: shares and securities registered with the Securities Commission on account of having been placed through a public offering and provided that they are traded on the Zagreb Stock Exchange or other organised markets; foreign securities as set out in the regulations of the Securities Commission; foreign and domestic mutual and investment funds investing primarily in quoted equities in OECD countries.

The Securities Commission may impose maximum, but not minimum (with the exception of requiring a minimum of 50% investment in central government long-term bonds),

proportions of the Fund's assets being invested in particular instruments.

The Fund's assets may not be invested in: securities unlisted or not publicly traded; physical assets which are not frequently quoted on organised markets or for which valuation is uncertain (antiques, works of art, motor vehicles); real estate or any interest in real estate.

Asset valuation and accounting

The value of the assets of a Fund shall be determined in accordance with the valuation principles. The Regulator shall issue regulations detailing principles for valuing the assets and liabilities of Funds.

Net assets of the Fund are valued on 'valuation dates' as determined by the Regulator, but not less often than once a month. The return for the last 24 months is determined by the Company governing the Fund at the end of each quarter: the investment return is based on the valuation of the net assets.

All internal bookkeeping and accounting of the Pension Companies and the Funds shall be done in accordance with international accounting standards.

Conflicts of interest

The same legal or natural person may not be a shareholder of more than three Pension Companies.

A member of the Board of Management or Supervisory Board of a Pension Company cannot be a person who is a member of a Board of Management or Supervisory Board of:

- any other Pension Company,
- any external asset manager, if appointed,
- the custodian holding the assets of the Fund,
- any person related to the Fund or the Company itself.

The Fund's assets may not be invested in securities issued by: shareholders of the governing Pension Company; the asset manager if appointed; the custodian; any related persons.

The custodian

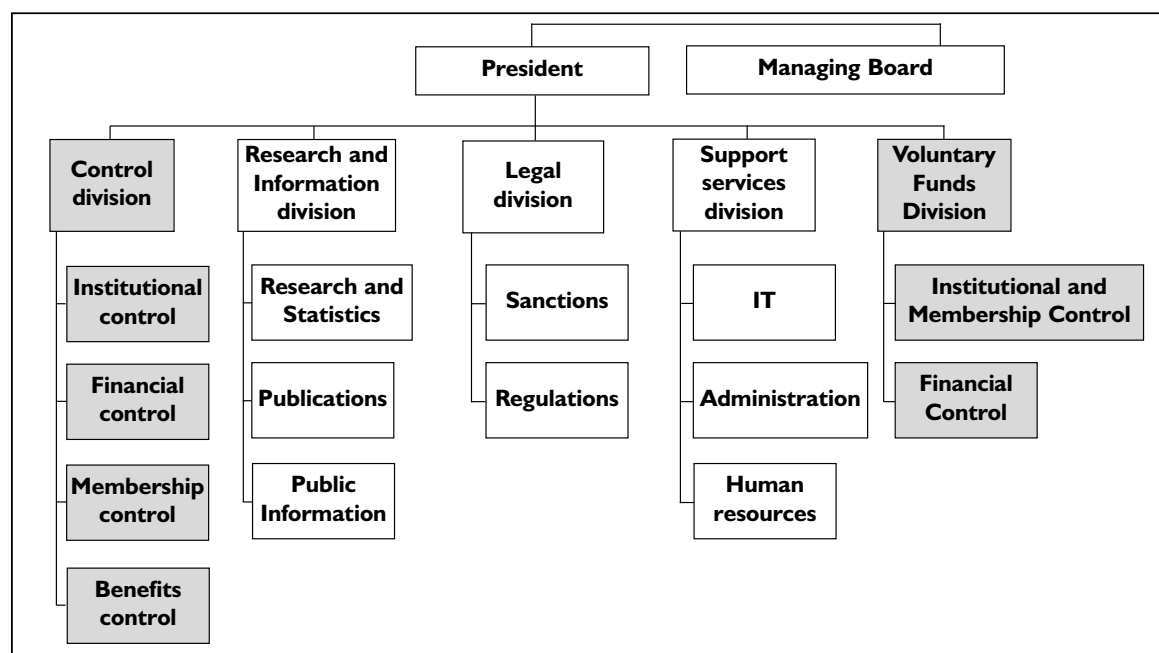
The Pension Company must appoint a custodian to keep the Fund's assets. A Company must appoint a single custodian for all the assets of the Fund managed. A custodian may act as such in relation to more than one Fund, but it must keep the assets and records of each Fund strictly segregated from each other and from those of the custodian.

Bankruptcy aspects

A Fund may not be declared bankrupt.

Fund's assets deposited and kept with a custodian may not be subject to execution against the custodian and may not be included in the bankruptcy estate of the custodian.

Graph 2. Croatia: The internal structure of an independent pension fund supervisory agency



Source: Taken from Rafael Rofman report on Croatia

6.5. The Case of Bulgaria*

Introduction

The currently operating pension system in Bulgaria is of a Pay-As You-Go (PAYG) type. This means that the financing of the old age pensions, disability and industrial accidents pensions, as well as survivor pensions, is done on the basis of the insurance contributions made by the current workers. The conditions for access to the pension system in Bulgaria are not very strict – the retirement age is comparatively low, there are early retirement schemes and the length of service required for retirement is already achieved in the middle of one's working career. At the same time, the pension benefits are rather low – the average pension constitutes about 1/3 of the average salary for the country. The recently established private pension funds still cannot fulfill their role of an alternative due to the fact that their functioning is not yet regulated in a special law, while the low incomes and the fear of financial pyramids refrain people from joining them.

Over the recent years a huge amount of social, political and expert energy has been spent (including international technical assistance) to prepare the White Book of Social Security Reform, develop a new Pension Act and make

amendments in the existing pension legislation. The major flaw of these attempted reforms was that the solution of the pension problem was sought only within the context of the current pension system. There was no political will and courage to undertake more radical reforms, incorporating a change in the conditions for access to the pension system. While looking for ways to adjust the pension benefits of the retirees, the new pensioners, who relied only on the public pension system, found themselves in the same miserable condition.

For the first time the *Bulgaria the 2001 Program* of the UDF proposed a new way for getting out of the wicked circle. The government of Bulgaria realised the need of radical reforms and adopted the idea of establishing a three pillar system based on the principle of security through diversity.

It is the purpose of the reform to establish a three pillar system:

- **Public mandatory pension insurance system of a PAYG type (first pillar).** This pillar of the pension system shall secure incomes to cover the larger part of the basic needs of pensioners like food, housing, medication. The PAYG system shall ensure a pension benefit equal to 40–45 per cent of the net salary prior to retirement.

- **Supplementary mandatory pension insurance (second pillar),** based on mandatory defined contributions accumulated into an individual account. Each working person shall have his own individual account where the

* Chapter 6.5 was based on materials provided by Ivaylo Nikolov, the Center for the Study of Democracy.

employer and himself shall make mandatory contributions that shall be exempt from taxes (respectively recognised as operational expenditures). The means shall be kept with a pension fund and invested by licensed private pension insurance companies. The amount of the pension benefit shall depend on the sum total of contributions, as increased with the revenues from investment, and reduced with fees and charges for the management of the pension fund. This pillar of the pension system shall ensure a pension benefit equal to 15–20 per cent of the net salary prior to the moment of retirement. Naturally, the longer the worker has contributed and the better the funds have been invested, the higher the benefit shall be. The state regulation here is extremely strict and includes also guarantees for a minimum investment earning.

– **Supplementary voluntary pension insurance** (third pillar), based on voluntary pension contributions, made by the worker or the employer in a voluntary pension fund. One can participate in voluntary pension insurance also with investment vouchers, and separate pension funds are set up to this end. The amount of the pension benefit is determined in the same way as with the second pillar. It is expected that about 1/3rd of the economically active population will participate in this option and their pension incomes will depend on their individual contributions and the social initiatives of their employers. This pillar is of an investment savings type with the ultimate objective of entitlement to a pension. The difference with the normal type of saving schemes or individual investment is to be found in the fact that part of the savings in the form of insurance contributions are tax exempt or recognised as operational expenditures. On the other hand, there is a strong government regulation of the pension insurance companies' activities, though at a more liberal regime than with the second pillar. There are no guarantees here for minimum investment earnings and the risk is shared between the insured persons and the pension insurance companies [10].

6.5.1. Key Issues of Pension Reform

Although most of the politicians support the establishment of a three pillar system, there is still no consensus and clarity as to the sequence and content of the reform. The key issues that are still the subject of debate include:

- How to achieve a better differentiation in legal terms between the pension insurance company and the pension funds administered by in the Bulgarian legislative context?
- Should the pension insurance companies be given the chance to administer more pension funds or restrict their activities to the management of one cash pension fund and one investment vouchers pension fund?

– What should be the structure of the pension funds from the second pillar – should they be occupational funds only, universal funds only or both types should exist side by side?

– What should be the level of the mandatory contributions for supplementary mandatory pension insurance?

– How to avoid the problem of double taxation of the current workers whereas they contribute first for the benefits of the present pensioners, and second – for their own pension benefits, in the conditions of a high insurance burden?

6.5.2. Main features of the Supplementary Voluntary Pension Insurance Act

The proposed Bill will settle social relations in supplementary voluntary pensions insurance through the introduction of legal regulation of the activities of the existing companies in the field of supplementary voluntary pension insurance and the provision of conditions for its development.

The main objective of the Bill is to provide conditions and opportunities for enhancement of the social protection of the population through supplementary voluntary pension insurance.

The additional objectives of the Bill are:

- to encourage the savings of the population,
- to stimulate employers' social initiatives,
- to promote the development of the securities markets in the country,
- to intensify the social drive of privatisation,
- to integrate the Republic of Bulgaria in social Europe.

The Bill was developed on the basis of the following **major principles**:

- 1) Voluntary participation,
- 2) Defined insurance contributions,
- 3) Insurance contribution sources: personal funds, employer funds and investment bonds,
- 4) Capitalisation of insurance contributions,
- 5) Keeping an individual account for each participant,
- 6) Differentiating the participant from the shareholder funds, including legal separation of the voluntary pension fund from the pension insurance company,
- 7) Clear and easily understandable formulation of the principal rights and obligations of the participants in SVPI, including:
 - their entitlement to old age, disability and survivor pensions,
 - their entitlement to a free choice among the "products" being offered: life pension benefits, pension benefits for a certain period of time (in years), lump or rescheduled

[10] This is also the principle difference between defined contributions voluntary pension insurance and life insurance, where the risk is taken by the insurance company offering defined pension benefits.

withdrawal of the moneys accrued in the accounts under the terms and conditions regulated by the law,

– their entitlement to transfer the funds accrued in their individual accounts from one SVPI Fund to another under the terms and conditions regulated by the law,

8) Functional and effective government regulation and oversight aimed at protecting the interests of the participants in SVPI,

9) A regime of licensing the administrative, actuarial and investment services available to the voluntary pension funds to pension insurance companies,

10) Government preferences and incentives for the development of SVPI,

11) Regulation of the capital adequacy and liquidity of the funds in the pension insurance companies,

12) Fair competition between SVPI companies,

13) Transparency in the pension insurance companies' activities, and

14) Mandatory regular accountability before the participants concerning the activities of the Fund and the cash flows in their personal accounts.

The following aspects of the Bill deserve **special attention**:

1) Primary focus on the protection of the interested of the insured persons through clearly defined and legally regulated rules governing the activities in the field of SVPI; stronger governmental control, separation of borrowed from equity funds, requirements for professionalism in the management of borrowed funds, transparency in the activities of the pension insurance companies.

2) Freedom of the insured to choose a pension insurance company, pension scheme and mode of participation, their entitlement to dispose of their own money. The Bill envisages some constraints upon these entitlements, especially for the cases when the insurance contributions are made by the employer or are in the form of investment vouchers.

3) Some specific rules are introduced for competent borrowed funds management and achievement of higher yields: a contract with an investment broker and depository or independent management provided by the pension insurance company on the ground of a special license. The right to participation of foreign investors and the investment of a limited part of borrowed funds outside the country guarantee yields in the conditions of underdeveloped capital markets in the country.

4) A special regime of participation is regulated for SVPI participation with investment vouchers and for their management through their differentiation in a separate pension fund of investment vouchers. Owing to the dynamics of the process of mass privatisation it is suggested that the specific forms and rules of participation of the pension insurance

companies in mass privatisation should be settled by decree of the Council of Ministers.

5) A combination of fees and yield appropriations are introduced towards the support of the pension insurance companies. The proposed fees in the form of % of the contributions are aimed to guarantee fixed revenues for the support of the activities of pension insurance companies regardless of the investment climate in the country. The second source of revenues to support their operations will be appropriations of up to 10% of the yields obtained from the investment of the moneys of the pension fund with a view to the more efficient management of investments ensuring uniformity in the interests of the parties to the insurance contract. The envisaged options for additional fees in connection with funds withdrawal and transfer in the order prescribed by the law or the requirement for information outside the legal prescriptions seek greater stability in the system and coverage of the extraordinary expenditures of the pension insurance companies.

6) The tax preferences indicated in the Bill are aimed at stimulating the participation in SVPI. Their specific amount will be defined in the relevant tax laws.

7) Special status and larger powers of the government supervisory agency combined with high professional performance requirements for its staff members; universal scope and uniform government supervision (through a unified agency) over the different forms of supplementary social insurance - pension, health and unemployment. Co-ordination of its operations with the competent government authorities: the Ministry of Labour and Social Policy, the Commission for Securities and Stock Exchange, the Bulgarian National Bank and the Insurance Supervision Directorate.

In the drafting of this Bill account has been taken of the principal ideas of the reform in the field of social insurance: transformation of mandatory social security (the first pillar); development of mandatory supplementary insurance (second pillar) and development of supplementary voluntary insurance (third pillar) in Bulgaria.

6.6. The case of Lithuania*

Introduction

In Lithuania, as in other post-Soviet countries, the creation of an independent state was associated with the rapid formation of new national institutions, including social security system institutions. Initially, pensions were treated like other social benefits paid from the state budget. As early as 1991, the social insurance fund was separated; later on pen-

* Chapter 6.6 was based on material provided by Audrone Morkuniene, from the Lithuanian Free Market Institute.

sion benefits became more actuarial in character, related to both the length and amount of contributions.

Pension reform in Lithuania was implemented in three main phases:

1) **Separation of the social insurance fund from the national budget in 1991.** The previous system, inherited from the Soviet regime, was not operating as financially independent. The separation from the budget made it possible to create the fund, which is administered by a tripartite council, representing employers' organisations, trade unions and the government.

2) **Arrangement of the public pension system in 1995, enacted through the Law on State Social Insurance Pensions.** Before this reform Lithuania operated virtually a flat pension system. The new law replaced pension eligibility criteria and pension formulae and raised the retirement age. This regulation resembles reforms applied in other countries Central and Eastern Europe, that put their public systems in order.

3) **Introduction of the supplementary pension pillar through the Pension Funds Act in 1999.** The law enables people to join the private pension fund on a voluntary basis.

In this section the main supervisory instruments relating to pension fund activities are presented. Since it is too early to study the results of pension funds, the analysis is based on solutions that were prescribed in the Law on Pension Funds.

6.6.1. Licensing of Pension Funds

Pension funds may be established as joint stock companies in a closed manner. This means that the first issue of a pension fund's shares may not be distributed publicly. Only the founders of a pension fund have a right to acquire them. This measure is intended to facilitate the examination of founders-shareholders' reputation and readiness to start pension fund activity before a license is issued.

A pension fund must obtain an official permit to start activity. Pension contributions may not be collected until such a permit has been obtained and a pension programme has been co-ordinated and registered with relevant regulatory institutions.

A permit to start a pension fund may be granted only to entities operating or established in accordance with the Law on Pension Funds. The main requirements are:

- equity capital of no less than four million litas (one million US dollars),
- readiness to start a pension fund in terms of facilities and qualifications (also founders' reputation),
- appropriate by-laws,
- a pension programme approved by supervisory institutions (the Securities Commission and the Ministry of Social Welfare and Labour),

- a three-year business plan,
- an appropriate depository, and
- an appropriate management company in case of outsourcing.

If pension fund activity is launched by an operating company, the Securities Commission also examines the last year's audited financial statements. Applicants are required to submit information about their selected depository and management company, if any. The Securities Commission has a right to require the submission of additional documents if such are necessary to adopt a decision regarding the issue of a permit.

A permit to start a pension fund must be issued during three months. A permit is not issued if the applicant fails to meet established requirements concerning documents and authorised capital. Borrowed funds may not be used to pay for authorised capital. In-kind contributions may not comprise more than 20 percent of authorised capital.

The supervisory authority may use licensing procedures to influence activity of pension funds at later stages of operation. If a pension fund violates the law or the interests of the insured, the supervisory institution may restrict the pension fund's activity or assign an administrator to oversee its operation for a period of no more than three months. During this period, a decision must be made whether to lift the restrictions or revoke the licence. There is a belief that a three-month period may be too short for a pension fund to ameliorate its situation. There is a danger that a licence may be revoked, and a pension fund liquidated, to the disadvantage of its members.

A permit to perform pension fund activity is revoked if a pension fund violates the law or fails to discharge liabilities towards its members, to rectify identified defects or to launch activity during a period of one year.

New licensing procedures are applied after a pension fund has been reorganised.

6.6.2. Regulation of Documents Related to Pension Funds

The law regulates the content of pension funds' by-laws. In addition to general requirements applicable to all joint stock companies, specific requirements are imposed on the formulation of pension programmes, distribution of investment income, and information disclosure to members of pension funds. Internal by-laws may be replaced only with the consent of the supervisory authority. Pension funds must obtain a permit from the Securities Commission to establish subsidiaries.

The Law on Pension Funds allows the establishment of both open-end and closed-end pension funds. The latter must stipulate certain participation restrictions in their pension programmes.

Pension fund activity is organised based on pension programmes. Pension programmes may vary by investment strategies, payment of contributions, and other participation conditions. The content of pension programmes is regulated by law. Pension programmes must be approved by the Securities Commission and the Ministry of Social Welfare and Labour plus registered with the former. Changes to pension programmes enter into force upon the approval of the Securities Commission.

A pension fund must conclude pension agreements with each payer of contributions. Payers of contributions may be members of the fund or other persons who will contribute on behalf of them. The Securities Commission, together with the Ministry of Social Welfare and Labour, establishes necessary terms of pension contracts. Pension funds have no right to terminate a pension agreement without the consent of the member, but members are allowed to do so. Breaches of the terms of payments of pension contributions may not serve as a basis for terminating a pension contract. Concurrent payment of contribution and receipt of benefits under the same pension programme are prohibited.

If contributions are to be paid by the employer on behalf of the employee, the employee may indicate a pension fund with which to conclude a pension contract. The employer may not shift onto the employee his obligation to pay pension contributions. An employee may volunteer to pay contributions under a contract signed by the employer.

A pension fund must keep a register of all members in accordance with rules prescribed by the Securities Commission.

Members of the pension funds may switch to another programme or another fund without incurring any sanctions a year. In case of repeated transfers, the pension fund to be quitted may charge a fee. If a member withdraws his savings before the retirement age without transferring them to another pension fund, sanctions are imposed: the pension fund must deduct either investment income accrued over the past three years or five percent of the sum withdrawn, whichever is bigger. The money received from sanctions is apportioned between other pension fund members.

The retirement age is defined in pension programmes. It may not be lower than the official retirement age by more than five years. Exemptions are applied to disabled individuals who may receive benefits as of the date when the disability was recognised. When a person reaches the retirement age, he is under no obligation to terminate accrual of funds or to withdraw his benefits.

The law defines possible types of benefits. These are benefits payable from personal accounts or a benefit payable for the purchase of an annuity in an insurance company. Pension funds are not allowed to pay annuities. Certain limits are imposed on the size of pension instalments payable from personal accounts for members who are not eligible for pensions provided by the state. A member who

did not purchase an annuity instantly has a right to do so for the sum remaining later on.

6.6.3. Regulation of Financial Activity and Investment

Pension funds are not allowed to carry out any activity unrelated to pension fund activity.

Pension accounts belong to pension fund members by the right of ownership. Pension accounts may be inherited. Pension contributions made by a third party on behalf of a pension fund member become the member's sole property as of the moment these contributions are received by the fund. Pension accounts may not be used to make disbursements not defined by the law.

The assets of members are financially segregated from the pension fund's own assets. Given that accrual of pension funds is administered under distinct programmes, the assets of these programmes are segregated as well.

To prevent creditors' claims to pension assets, pension funds are not allowed to extend loans, to guarantee with, or to mortgage, its assets, except when a pension fund takes a short-term loan guaranteed with its assets to maintain liquidity. Pension funds may not borrow for any other purposes. Pension funds are not allowed to be founders of companies or to issue bonds.

Pension funds must assume an obligation in their pension programmes to provide a certain level of investment return for their members. Pension funds are allowed to set the minimum level of investment return themselves. This level may not be lowered later on. To be able to discharge its liabilities, a pension fund must form a guarantee reserve fund. The procedures of forming the fund are defined by the Securities Commission. If investment income and guarantee reserves are lacking for a pension fund to discharge all its liabilities, equity capital must be used.

The law stipulates requirements for the apportionment of investment income. Investment income is used in the first place to discharge liabilities arising from pension programmes. The remaining funds are apportioned as follows: 80 percent is distributed among pension fund members, and 20 percent goes for the pension fund.

Each pension programme must define the procedures for covering administrative costs. No limits are imposed on administrative expenses. Profits generated by pension funds may not be used to pay bonuses and dividends if capital adequacy, equity capital and reserves appear to be lower than required by law or the Securities Commission.

Pension funds are subject to a capital adequacy requirement which is intended to ensure sufficient reserves calculated based on investment risk for a pension fund to discharge all its liabilities (first of all, profitability of pension programmes). Yet, this requirement does not secure an

adequate ratio of equity capital to assets managed. It may be acceptable to replace the capital adequacy requirement with a certain ratio of equity capital and assets under management.

Other requirements applicable to pension funds include liquidity ratio and the maximum open position in foreign currency. The usefulness of the liquidity requirement is questionable given that pension funds will not pay pensions themselves. The maximum open position in foreign currencies will restrict investments abroad. The latter may not prove the best way to protect members' interests given that investments abroad may accommodate better diversification and investment safety.

Pension funds are allowed to hire management companies to administer their investments or the whole of their activity. The general meeting of shareholders must approve agreements with management companies. Management companies may not be replaced without the Securities Commission's consent. Management companies must compensate for the harm incurred by pension funds through their fault.

Special requirements are applied to management companies. Management companies must obtain a permit from the Securities Commission. Only specialised institutions can act as management companies, because in order to comply with EU requirements they are prohibited from performing any other activity. This may partly be explained by the fact that performance of pension fund management by operating financial institutions (banks, insurance companies) would complicate their supervision.

A management company may be related to the pension fund, but the depository must be independent. A pension fund may not be related to its management company and depository through employees. The same people may not hold top positions in a pension fund and its management company or depository.

Investment restrictions

Investment regulations follow the listing rather than the "prudent man" rule. They define allowable investments and investment limits. Investment portfolios may comprise securities, real estate, deposits in commercial banks, and deposit certificates issued by banks.

The requirements for investment portfolio diversification comply with international standards: pension funds may not acquire more than 10 percent of securities of one issuer and investments into one issuer or one property item may not exceed 5 percent of pension assets. These restrictions are not applied to government securities. Here, no mandatory minimum levels are prescribed.

The law defines types of securities into which pension funds may invest. These are treasury bills, issues quoted on the Official List of the National Stock Exchange of Lithuania, plus other liquid securities recognised by the Securities

Commission. The same diversification requirements are applicable to investments abroad. No limitations are imposed on the amount of investments abroad. Yet, the law prescribes the maximum open position in foreign currencies. The concept of sponsorship? is not stipulated in the law.

Pension funds are prohibited from investing into their own securities or securities issued by other pension funds.

Investments into real estate may not exceed 20 percent of pension assets. Not more than 25 percent of pension assets may be invested into related persons. The Securities Commission has a right to impose additional restrictions on investments into securities or deposits in commercial banks.

Given that the assets of each pension programme are administered separately, each pension programme is subject to distinct diversification and other requirements. The equity capital must be invested into a diversified portfolio, which is subject to the same investment requirements as members' assets.

6.6.4. Regulation of the Safekeeping of Assets

All assets belonging to pension fund members must be transferred to a depository for safekeeping. A depository must be an independent institution not related to the pension fund or its management company. The Securities Commission may impose requirements on a pension fund's depository in addition to those stipulated by the law governing depositories. The assets transferred to a depository for safekeeping must be segregated from the depository's own assets. The assets of distinct pension programmes must be administered separately.

The depository not only safeguards pension assets, but also examines whether transactions with the pension fund comply with the law, the pension fund's by-laws, and programme requirements. The depository is liable for damages to the pension fund.

A pension fund may make the decision to be liquidated provided it has transferred all its liabilities to other pension funds and provided the latter does not worsen programme conditions. If the license has been revoked, a decision to liquidate a pension fund may also be adopted by the Securities Commission. In such cases the Securities Commission assigns a liquidator. If a pension fund is liquidated by the decision of the Securities Commission, all assets of pension fund members must be taken over by other pension funds. The remaining assets are sold and apportioned between shareholders.

If a pension fund is to be reorganised, it must obtain approval for the reorganisation project from the Securities Commission and the Ministry of Social Welfare and Labour.

If a pension fund is being liquidated or reorganised, or a pension programme is terminated, the pension fund may

transfer its liabilities without members' consent provided participation conditions are not worsened and the supervisory authority has granted its consent. Members who are dissatisfied with such decisions have a right to switch the new programme free of charge.

Since the pension fund's and members' assets are segregated and the money held in pension accounts belongs to the members by the right of ownership, this money, in the event of the pension fund's bankruptcy, is returned to the members before creditors' claims are satisfied. If money is lacking to discharge all liabilities, the pension fund covers the shortfall with its equity capital. As soon as bankruptcy proceedings are instituted, all operations of the pension fund are suspended, except for accrual of investment income and other operations necessary to proceed with liquidation.

6.6.5. Management and Responsibility

Since the Law on Pension Funds is based on the Law on Joint Stock Companies, the establishment of a council and board of pension funds, as well as the definition of their powers and responsibilities, is regulated by the Law on Joint Stock Companies. Definition of the establishment and competence of managing bodies is also required in pension fund by-laws.

The Securities Commission has a right to require a pension fund to convene an extraordinary meeting of shareholders.

Pension funds as well as their management companies and depositories must act in the best interest of the pension fund members. Members of the council and board as well as top managers have a joint liability for compliance with statutory provisions and performance of the duty to act in the best interest of the members of pension fund. They must compensate the pension fund for damages incurred through failure to perform the said duties. This may also be a basis for the supervisory authority to intervene and impose sanctions.

An independent audit of a pension fund is mandatory after each business year. The terms of an audit contract must be co-ordinated with the Securities Commission. Pension funds may also set up temporary controlling commissions.

6.6.6. Information Disclosure

Only a company established under the Law on Pension Funds and conducting pension fund activity has a right to use the words "pension fund" in its name.

A pension programme is the main document regulating participation conditions. Before signing a pension contract,

each member must be familiarised with the pension programme, which constitutes part of the contract. If a programme is being replaced, each member and payer of contributions must be notified in writing about the changes no later than 30 days before these changes come into effect.

The pension fund must notify its members about non-compliance with the payment of pension contributions if these are paid by third parties.

The Securities Commission must announce information about reorganisation or liquidation of pension funds according to established rules so that this information would reach every member and payer of pension contributions. In addition, every interested person has a right to receive from the pension fund information about the process of reorganisation. Members of the pension fund and the Securities Commission must be notified about the pension fund's decision to terminate a pension programme within five working days.

The law provides for periodic financial accountability: each year's audited reports plus semi-annual reports must be submitted to the Securities Commission and announced publicly. Members of pension funds are allowed to receive copies of these documents on demand. Pension funds are required to notify their members in writing at least once a year about their account statements, about changes to legal acts relating to pension funds, depositories and management companies, and about changes regarding depositories and management companies. Pension programmes define the content of such notices. It is our opinion that the periodicity of reports about account statements should be increased over time.

Management companies are also required to submit financial reports to the Securities Commission according to its established procedures.

6.6.7. The Powers of the Supervisory Authority

Lithuania has opted for an operating non-specialised supervisory institution of pension funds. Pension supervision will be delegated to the Securities Commission, which supervises the capital market. This option has been prompted by the fact that pension funds will be savings institutions similar to investment funds and will represent a voluntary supplement to the existing public pension system. The Securities Commission will have a right to inspect pension funds, to issue mandatory instructions and to impose sanctions.

The Ministry of Social Welfare and Labour will oversee the formulation of pension programmes, their compliance with collective agreements, the discharging of employers' liabilities to pay pension contributions, and the application of restrictions on the payment of benefits from pension accounts.

Conclusions and Recommendations

The development of pension funds as private financial institutions that invest savings for future pensions is being effected by a great variety of means. This is apparent not only in Western countries with a rich tradition of market solutions in many areas of the economy and social relations, but also in Central and Eastern European countries that started from the same position, one might think, when they gave up a centrally planned economy and started to build a market economy.

The varied paths leading to the development of pension funds means that supervision over them takes different forms as well. Experience shows there is no universal recipe for proper supervision.

One must ask why supervision is necessary at all, and what proper supervision entails. As has been mentioned previously (see Chapter 2), the development of pension funds during the first historical period of their establishment took place more or less without any outside supervision. Today, though, both newly established institutions and old ones are under supervision. Why is this so?

It seems there are two basic causes that combine to strengthen the arguments in favour of supervision.

Firstly, the share of the pensioner population's income from saving in pension funds is growing, regardless of whether participation in the funds is compulsory or not. This population will grow because Western societies are ageing dynamically. A pension from a pension fund will not be (and in many countries already is not) just a marginal solution for the wealthier group of the senior population, but an increasingly widespread way of securing income for old age. The safe and effective functioning of the funds will thus be an important criterion of trust in the State, the economic system and its institutions.

Secondly, contemporary market economies are not free of crises, especially financial ones. Many individual institutions and whole groups fall victim to weak (short-sighted) regulations and bad management, as well as fraud. The economies of countries who practised central planning until recently, possessing little market experience and a huge

deficit of regulations adapted to the new system's logic, are especially susceptible to crisis. At the same time, the crisis of any market institution in any country can cause a great loss of trust among society in general. Change, meanwhile, requires motivation and positive examples to stimulate people to private activity and participation in market solutions. That is why financial institutions, thanks to which the average citizen gains market experience, should be extremely solid.

To decide what proper supervision means, one has to understand that the financial risk linked to pension funds is an element of the overall risk found in the financial system. The existence of risk, as a "natural" component of that system, has to be calculated into both regulation and supervision [11]. This paper has attempted to provide a detailed analysis of risks and, furthermore, even to rank them. However, it is impossible to say unequivocally what kind of supervision is proper. Let us try, nevertheless, based on an analysis of different countries' experiences, to show certain conditions and qualities for the proper supervision of pension funds.

– The first condition involves the necessity of complying simultaneously with safety criteria and effectiveness criteria. Due to the great importance of this for pension funds, a separate supervisory body is created for them. When the supervisory body is common for different types of financial activity and covers an excessively large part of the financial market (e.g. the banking or insurance system, or the whole financial market as in the United Kingdom), the trend to disregard the interests of fund members can occur more frequently. Where this happens, supervision identifies with the interests of the pension fund industry as a part of the sector undergoing supervision rather than defending future pensioners against excessive financial risk (this is called "supervisory capture"). Common supervision leads to a situation where, in the course of time, specialist analytical institutions are separated out, and this reduces the danger of domination of the sector's interests over its clients. Thus, institutional unity is not maintained. Admittedly, establishing a sep-

[11] Sometimes the difference is emphasised between regulation and supervision for the purpose of order; regulation means creating laws, and supervision means putting those laws into practice in accordance with the letter of the law while eliminating deviations and irregularities.

arate supervisory body just for pension funds does not solve the problems involved with balancing the criteria. What is needed is a supervisory body that would have extensive competence in both financial supervision and legal supervision. In practice, achieving such harmony of competence is not simple. Supervision employees would have to have the same financial qualifications as those who manage the funds. Since supervisory bodies are usually government agencies that are unable to compete with commercial (private) companies for employees highly qualified in finance, supervision over pension funds is entrusted to bodies that supervise the stock exchange, banks or insurance companies. However, if there is a separate supervisory body, as is the practice in the model-creating countries of South America (Chile, Argentina) and subsequently adopted by Hungary and Poland, the problem arises of obtaining and paying the best experts for such a body. They would have to earn about the same as members of the pension fund management board – and these are high salaries, far higher than government administration salaries. In supervisory bodies that are government agencies, drastic salary differences between government administration employees are very hard to accept, and practically impossible to implement, though the example of Argentina seems to show that this is in fact possible (salaries in supervision are 50% higher than in the management boards of the best funds). Let us not forget, however, that Argentina's *Superintendencia* is a largely autonomous institution.

– The second condition relates to the independence of the supervisory body. The issue here is independence in a broad sense, both from political influences and the influence of the funds themselves, as well as other pressure groups. Due to the growing share of assets in the funds, which is turning them into a serious financial force, they are increasingly becoming the object of pressure and political coquetry that occasionally has serious consequences on their effectiveness. Independence from political influences can be achieved by the proper placement of the supervisory body and well-defined methods for choosing its head, with the participation of parliament to ensure its functional stability in the longer term. One important element of such a body's independence is to ensure it has independent financing. The source of funding should be commission from the funds rather than an annual state budget subsidy. Budget financing makes it difficult to use aggressive salary motivation for

employees of the supervisory body (see above), which in turn is a condition for attracting highly qualified people in the financial field to supervise pension funds.

– Independent supervisory bodies should have the right to submit drafts of changes in the regulations or of additional regulations on the operation of pension funds. They should also provide opinions on draft regulations proposed by others. This right is especially important in countries with little experience in regulating the financial sector – in the countries undergoing transition. The supervisory body is quickly becoming one of the most competent institutions in the sector, and while it should maintain its independence, its voice should be ensured the proper rank in initiating new regulations. This does not mean, though, that the supervisory body should be created as the fundamental regulatory institution (in accordance with the active supervision model). Its initial assets in improving the regulation of the pension fund sector could be transformed into the defects of a leading decelerating force, weakening the market adaptation of the funds themselves and their capacity for self-regulation.

– With supervisory bodies in countries where participation in pension funds is obligatory for a certain group or for the whole population, and where the pension from the fund *de facto* becomes a component of social security, supervision should be developed along stricter and more draconian lines. It needs to be exercised exceptionally scrupulously, even though there are other safeguards in such cases (e.g. a defined investment structure and investment limits, a minimum rate of return, a guarantee fund). In the case of pension funds operating on the basis of voluntary participation and greater freedom of choice regarding not just the fund but also the investment options, a distanced form of supervision (within reactive supervision) is permissible. The "prudent man" concept forms the basis for this type of supervision.

– Institutions exercising supervision of pension funds should be legally obligated to co-operate with other supervisory bodies and regulatory bodies. The obligation of co-operation should also concern the public part of the pension sector. In the countries undergoing transition, it is as yet difficult to achieve this kind of co-operation. Had it existed, it would have allowed several risks that became apparent at the start of the pension funds' functioning to be avoided.

Appendix

Legal Provisions Regarding the Supervision of Pension Funds in Selected Countries of Central and Eastern Europe

A-I. The case of Hungary: Act on Private Pensions and Private Pension Funds (Act LXXXII of 1997) [fragments]

Chapter XI. State Guarantees, State Supervision of Funds

Section 100.

The State shall secure the operation of the private pension system by enforcing the rules of institutional protection, by maintaining state supervision and by assuming financial guarantees from the central budget for the solvency of the Guarantee Fund, which guarantees the payment of the fund members' claims.

Section 101.

Legal supervision of the funds shall be carried out by the General Prosecutor's office in compliance with the relevant governing rules, and state supervision shall be carried out by the Minister of Finance through the Private Fund Supervisory Board.

Legal Status and Scope of Responsibility of the Private Fund Supervisory Board

Section 102.

1. The Private Fund Supervisory Board is a national, administrative organisation in the first instance operating as an independent central office under the supervision of the Minister of Finance.

2. The Private Fund Supervisory Board is a legal entity and operates as an organisation funded by the central budget, with semi-independent finances. The Fund Regulations of the Private Fund Supervisory Board shall be approved by the Minister of Finance. The registered office of the Private Fund Supervisory Board is in Budapest.

3. The authority of the Private Fund Supervisory Board includes the supervision of the activities of organisations specified in Section 2 of this Act, as well as tasks and authority specified by VMIFA.

4. The Private Fund Supervisory Board shall act in compliance with SAPR with due regard to the provisions listed in this Act.

5. Appeals against the resolution of the Private Fund Supervisory Board may be submitted to the Minister of Finance.

6. The Private Fund Supervisory Board has the right in the preparation phase to examine legal regulations related to the system of social security, mandatory and voluntary pension funds, and to make recommendations on the formulation of relevant legal regulations and the amendments thereof.

7. The Private Fund Supervisory Board may sign agreements of co-operation, may exchange information which is not classified as personal data with foreign supervisory authorities or international organisations established by such authorities, and may join such organisations as a member. The Private Fund Supervisory Board may utilise data and information received from foreign supervisory authorities to improve its performance, as well as to have a better basis to judge applications, pass resolutions, take measures or impose sanctions. The Private Fund Supervisory Board may disclose data and other information to the above mentioned organisations for the same purposes, within the framework of international co-operation.

8. The Private Fund Supervisory Board shall officially publish its resolutions and opinions in the "Financial Gazette".

Section 103.

1. Any person who serves or served in a civil service capacity, other work-related, or commissioned legal relationship with the Private Fund Supervisory Board, shall maintain business and fund secrets related to the activities of the funds which are/were disclosed to him while carrying out supervisory tasks. Secrecy shall be maintained without any limitation in time, even after the termination of the legal relationship with the Private Fund Supervisory Board.

2. Any such person as referred to in Subsection 1. shall not use business or fund secrets disclosed to him to gain advantage for himself or for any other person directly or

indirectly through such secrets, nor to cause any detriment to the fund or fund members.

Power of Appointment President of the Private Fund Supervisory Board

Section 104.

1. The President of the Private Fund Supervisory Board shall be appointed for a term of six years, and the vice-president(s) for an indefinite period, by the Minister of Finance, who shall also exercise the employer's rights over the President and the vice-president(s).

2. The status of the President, vice-president(s) and employees of the Private Fund Supervisory Board shall be governed by the provisions of CSA, with respect to the provisions of this Act, with the exception that the rates set out in Subsection 3. of Section 30/A, Paragraph b) of Subsection 5. of Section 42 and Subsection 1. of Section 44 of CSA may be increased to the extent specified by legal regulations pertaining to the ministries.

3. The President and the vice-president(s) of the Private Fund Supervisory Board shall be Hungarian citizens with no prior criminal record, a higher education in the field, and at least five years of management experience in the field of finance, business, or public administration. The Minister of Finance may grant a two year exemption from the five-year experience requirement; furthermore, the Minister of finance may also grant an exemption from the requirement that the higher education degree be in the field, provided that the candidate has had five years experience in the field.

4. As regards the appointment of the actuary of the Private Fund Supervisory Board, the provisions of Subsections 2-4 of Section 47 of this Act shall apply.

5. The appointment of the President and the vice-president of the Private Fund Supervisory Board shall be terminated through discharge if:

a) according to a final judgement of the court they have committed a crime, or have become unworthy of their positions in any other way,

b) they have permanently become unable to fulfil their functions,

c) they have not eliminated conflicts of interest with their functions.

6. The President of the Private Fund Supervisory Board shall

a) represent the Private Fund Supervisory Board in Hungary and abroad;

b) manage the activities of the Private Fund Supervisory Board;

c) exercise the employer's rights over the employees of the Private Fund Supervisory Board, and make recommendations on exercising employer's rights related to the vice-president(s);

d) exercise rights related to the financial management of the Private Fund Supervisory Board;

e) order measures and impose penalties;

f) exercise all rights vested in him by the Fund Regulations of Private Fund Supervisory Board pursuant to this Act.

7. The President of the Private Fund Supervisory Board may transfer his powers specified in Paragraphs c)-e) of Subsection 6. with the exception of the right to make recommendations on exercising employers rights related to the vice-president(s).

Conflict of Interest

Section 105.

1. The President, vice-president(s) and civil servants of the Private Fund Supervisory Board shall not be in an employment relationship, in any legal relationship with the purpose of work, in a membership relationship in terms of a corporation or partnership involving personal contribution, or ownership relationship with any fund, legal entity in contractual relationship with that fund, the Guarantee Fund, or any organisation involved in social security activities. The said persons may not be senior officers of or members of any organisation entrusted with the supervision thereof.

2. The President, the vice-president(s) and the civil servants of the Private Fund Supervisory Board, and the persons listed in the Subsection 1 shall not be close relatives of each other, and shall not act in issues in which they or their close relatives have interest.

3. Persons specified in Subsection 1 shall immediately notify the person exercising the employer's right of the existence of conflicts of interest specified in Subsections 1 and 2 and eliminate any conflict of interest as specified in Subsection 1 with immediate effect. The party exercising employer's rights may require the person concerned to eliminate such conflict of interest, even if he fails to fulfill the requirement of notification. If the persons concerned fail to eliminate such a conflict of interest, the civil servant status of such persons shall be terminated by the Private Fund Supervisory Board. In the event of conflicts of interest specified in Subsection 2, the party exercising employer's rights shall decide whether or not the cause of conflict of interest shall be eliminated, and whether the person notifying the Board is entitled to act in the given circumstance.

Responsibilities of the Private Fund Supervisory Board

Section 106.

1. The Private Fund Supervisory Board shall:

a) supervise compliance with the provisions of the law and the legal regulations issued on the basis of authorisation conferred by the law;

b) evaluate applications for licenses, and ensure that the funds operate in compliance with such licenses;

c) appoint a Supervising Commissioner in the events specified in this Act;

d) co-operate in discovering and eliminating obstacles which hamper the development of the funds and the Guarantee Fund, in co-ordinating the co-operation of the above with the social security bodies;

e) operate an auditing and information system;

f) determine, in advance, on an annual basis, the expected and minimum return requirement on the funds' investments with a method of calculation specified by law;

g) approve the regulations of the funds.

2. The Private Fund Supervisory Board shall permanently make the following documents and data of the funds available to anyone interested, free of charge:

a) deed of foundation,

b) Fund Regulations,

c) benefit regulations,

d) minutes and resolutions of the General Meetings,

e) registered office, site(s), branch(es), affiliate(s),

f) tax number,

g) the assets of the fund,

h) names, addresses and positions of the authorised representatives,

i) mode of representation,

j) names and addresses of senior officers,

k) name and address of the auditor,

l) annual reports.

3. The Private Fund Supervisory Board shall fulfill its tasks related to the voluntary mutual interest funds in compliance with a separate law.

Section 107.

1. In fulfilling its tasks, the Private Fund Supervisory Board shall have the right to issue licenses, exercise control, take measures and impose penalties.

2. While exercising its rights, the Private Fund Supervisory Board shall not compel the fund to carry out financial management other than approved in the Fund Regulations and in the financial plan, unless the fund is temporarily insolvent.

Licensing Authority

Section 108.

The license of the Private Fund Supervisory Board shall be obtained:

a) to establish a fund;

b) to start the fund's operation;

c) to implement the benefit regulations, and to start the provision of fund services.

Right of the Private Fund Supervisory Board to Control, Take Measures and Impose Penalties.

Section 109.

1. The Private Fund Supervisory Board shall have the right at all times and an obligation to monitor every second year whether the activities performed by the fund are in

compliance with the law and other legal regulations related to the fund activities, the licenses granted by the Private Fund Supervisory Board and the safety of the fund members. To this effect, the Private Fund Supervisory Board shall have the right to require the production of data, reports, statements and inspection materials related to the performance of the fund, or which are necessary to carry out the audit, and to examine these documents on site, even without prior notice, as well as to request reports.

2. The Private Fund Supervisory Board shall operate an information system through which it can be connected directly to the information system of the funds and the Guarantee Fund. The detailed rules pertaining to the common information database shall be determined by the Government in the form of a decree.

3. In order to carry out the supervisory tasks specified in Subsection (1), the Private Fund Supervisory Board may send an employee, an independent auditor or other experts to the fund to carry out a general or specific audit, as well as to enforce the fund's reporting and accounting obligations.

Section 110.

1. For the purpose of the fulfillment of the obligations of the fund, the protection of fund members' interests, as well as the implementation of the relevant legal regulations, the Private Fund Supervisory Board may take the following measures:

a) it may issue a notice, and set the deadline, if required, for the full implementation of provisions specified in this Act and in other legal regulations relating to the activities of funds;

b) it may require the submission of an action plan by a given deadline, and may also set a deadline for the implementation of such an action plan;

c) it may initiate accountability or discharge proceedings in respect of the manager concerned;

d) it may convene the meeting of the Board of Directors;

e) it may convene an extraordinary General Meeting;

f) it may impose a supervision penalty;

g) it may withdraw the operational license granted for fund activities and, in this case or in the case of voluntary dissolution, it may temporarily order that the fund members pay their membership contributions to the Guarantee Fund; it shall ensure, by the designation of the appropriate fund, that fund members may become members of the designated fund within sixty days at the latest;

h) it may initiate the revision of the financial plan, and the modification of the Fund Regulations;

i) it may initiate legal proceedings in court to liquidate the fund;

j) it may appoint a Supervising Commissioner;

k) it may suspend the admission of fund members;

l) it may suspend the operation of the fund while concurrently appointing a Supervising Commissioner, and may suspend the admission of fund members.

2. The operational license may be withdrawn if:
- a) the fund fails to start operating within 180 days of the date the license takes effect, or if it suspends operation without the approval of the Private Fund Supervisory Board;
 - b) the fund has disclosed false information or statements in the application for license, and, upon notice, fails to modify the information or statements accordingly within thirty days;
 - c) the fund fails to meet the requirements specified in the license;
 - d) the fund seriously breaches the provisions of legal regulations related to fund activities, or does not comply with the resolutions of the Private Fund Supervisory Board, and therefore seriously jeopardises the interests of fund members;
 - e) the fund is involved in activities other than those for which it is licensed;
 - f) the conditions for the issuance of the license are no longer fulfilled, and remedy of this situation is not possible within an appropriate period of time.

Section 111.

1. The Private Fund Supervisory Board may impose penalties on any members of the Board of Directors or the Private Fund Supervisory Board who violate the Fund Regulations, are involved in activities which are contradictory to the Fund Regulations, operate a fund without an operational license, or fail to abide by measures taken or resolutions passed by the Private Fund Supervisory Board. The amount of the penalty may range from HUF 100,000 to HUF 1,000,000. The payment of the penalty shall not be assumed by the fund.

2. The Private Fund Supervisory Board may impose penalties on the fund if the fund does not change any unlawful practices or practices violating the Fund Regulations, or violates the relevant accounting and financial requirements. The upper limit of the penalty shall be 0.3 per cent of the annual membership contributions, and may be imposed repeatedly. If the fund deviates from the rules and general regulations on investments, and repeatedly violates the rules relating to conflict of interest, the upper limit of aggravated penalty shall be one per cent of the annual membership contributions.

3. The penalty imposed by the Private Fund Supervisory Board shall be paid within fifteen days of the receipt of the legally final judgement, to the account specified in such judgement.

Section 112.

The Private Fund Supervisory Board shall not impose any penalty beyond six months after the default or the violation of obligations becomes known to the Private Fund Supervisory Board, or beyond two years after the default or the violation of obligations.

Supervising Commissioner

Section 113.

1. The Private Fund Supervisory Board may recommend that the fund prepare an action plan if it is assumed that the fund will not be able to meet its obligations.

2. If the fund fails to comply with the provisions of the action plan, or the action plan fails to promote safe operation of the fund, the Private Fund Supervisory Board may appoint a Supervising Commissioner. The Private Fund Supervisory Board may also appoint a Supervising Commissioner if the deficiencies discovered in the accounting or internal control system of the fund are so grave that it is impossible to evaluate the actual financial standing of the fund, or if the Board or Directors of the fund may not fulfill its duties, and thus jeopardises the fund members' interests.

3. The Supervising Commissioner may only be a person who has no business relations with the fund and is not a member thereof.

4. The Commissioner shall investigate the financial standing and financial assets of the fund, and prepare the fund for the production of a report. The Supervising Commissioner shall convene a General Meeting within fifteen days of the completion of his inspection.

5. The activity of the Supervising Commissioner shall aim to restore the fund's operability. In this period the fund shall act in compliance with the directives of the Supervising Commissioner appointed by the Private Fund Supervisory Board, and the Supervising Commissioner shall exercise the rights of the Board of Directors and the Managing Director.

6. The Supervising Commissioner may be appointed for a period of maximum 180 days; this period, however, may be extended pending the appointment of a liquidator. In the event of liquidation proceedings, the appointment of the Supervising Commissioner shall end upon appointment of a liquidator.

Section 114.

1. The commission of the Supervising Commissioner shall specify his duties and scope of authority, which shall exclusively include compliance with and enforcement of the rules specified in this Act, and legal regulations implementing this Act.

2. The Board of Directors of the fund shall be notified of the appointment of a Supervising Commissioner.

3. Upon request, the Supervising Commissioner shall notify the Board of Directors of the fund of the measures taken by him in writing within three days.

4. The Supervising Commissioner shall be eligible for remuneration, the amount to be determined by the President of the Private Fund Supervisory Board and payable by the fund concerned.

Section 115.

If the financial standing of the fund does not enable the fund to operate in accordance with the Fund Regulations,

the Private Fund Supervisory Board may order the suspension of the fund's operation, and may initiate legal proceedings to liquidate the fund.

Revenues of the Private Fund Supervisory Board

Section 116.

Revenues of the Private Fund Supervisory Board are as follows:

- a) supervision fee,
- b) other revenues.

Section 117.

1. The funds shall pay the supervision fee to the Private Fund Supervisory Board from their operational reserves.

2. The supervision fee shall total 0.2% of the membership contributions paid.

Section 118.

1. The supervision fee shall be transferred by the funds to the account of the Private Fund Supervisory Board on a quarterly basis, by the thirtieth day of the month following the quarter under review, on the basis of the fund's actual membership revenues in the quarter under review.

2. The supervision fee shall be utilised to cover the operational expenses of the Private Fund Supervisory Board. Calculation, accounting and utilisation of residual funds at the end of the year shall be governed by legal regulations applicable to financial planning, financial management and the reporting systems of state-funded organisations.

Data Management by the Private Fund Supervisory Board

Section 119.

1. In order to fulfill its tasks as specified in this Act, the Private Fund Supervisory Board may manage, i. e., store and use data, including personal data specified in this Act.

2. In order to fulfill its tasks, the Private Fund Supervisory Board may store and use the data, specified in Schedule No. 2 to this Act, of fund members and the senior officers of the funds, as well as data pertaining to the conflict of interest and qualification requirements of the fund's officers and employees.

Section 120.

The central record keeping of the funds shall be carried out by the Private Fund Supervisory Board within its own organisation. If the Private Fund Supervisory Board judges from the available data that in any fund the safety of benefits is jeopardised due to some malfunction, or the performance-related data of the funds show remarkable disproportion, or it is presumed that the law or legal regulation has been violated, the Private Fund Supervisory Board shall take the necessary measures.

Chapter XII. The Private Fund Council

Section 121.

1. The Private Fund Council is the consulting body of the Private Fund Supervisory Board.

2. Members of the Private Fund Council are as follows:

a) the representatives of the Ministry of Finance, the Ministry of Welfare and the Ministry of Labour (one representative each);

b) the representative(s) of the Alliance(s) of Funds;

c) four independent experts invited by the Minister of Finance upon the recommendation of the president of the Private Fund Supervisory Board;

d) the representatives of the State Insurance Supervisory Board, the State Supervisory Board of Money and Capital Markets, the National Bank of Hungary and the Budapest Stock Exchange (one representative each);

e) the representative of the Guarantee Fund;

f) a representative delegated by the Pension Insurance Fund Administration,

g) the representative of chambers in which fund service providers are members,

h) interest representation bodies in which fund service providers are members.

3. Members of the Private Fund Council shall be elected from among Hungarian citizens with no prior criminal records, who have a higher education degree and a high-level of expertise in the field of pension systems, investment or insurance.

4. The President and vice-president of the Private Fund Council shall be appointed by the Minister of Finance from among the persons referred to in Paragraph c) of Subsection (2).

5. The members of the Private Fund Council, with the exception of the President and the vice-president, shall not be eligible for any remuneration for carrying out the tasks assigned to them. The operational conditions of the Private Fund Council shall be ensured by the Private Fund Supervisory Board.

6. The Private Fund Council shall

a) make recommendations concerning the activities of the funds and the Guarantee Fund, as well as concerning changes in their operational conditions, their roles in the money and capital markets, concerning experience with regard to the implementation of legal regulations related to the funds, concerning the bills and drafts of legal regulations related to the scope of responsibilities of the funds, the practice of consistent asset evaluation and performance assessment techniques of the funds, the regulations on investment diversification and concerning the minimum return requirements of the funds,

b) put forward proposals in the given field and in terms of ethical conduct, and shall publish these proposals in co-operation with the Private Fund Supervisory Board,

c) prepare, have others prepare, and publish professional publications related to the funds.

A-2. The case of Poland: Act on the Organisation and Operation of Pension Funds, passed on 28 August 1997 [fragments]

Chapter 21: Supervision of the Operation of Funds

Article 199

1. The Supervision Authority is established under this Act as a central public administration body.

2. The Supervision Authority shall be supervised by the President of the Council of Ministers.

Article 200

1. The task of the Supervision Authority shall be to protect the interests of Members of Funds and participants of the employee pension schemes.

2. The task of the Supervision Authority shall be carried out by:

- 1) supervising the operation of Funds;
- 2) inspiring, organising and enhancing the development of the pension fund system in Poland;
- 3) supervising the operation of employee pension schemes;
- 4) creating and developing public awareness of the purposes and operating principles of the Funds, with particular regard to rights vested in their Members;
- 5) creating and developing public awareness of the purposes and operating principles of employee pension schemes, with particular regard to rights vested in their participants;
- 6) co-operating with state administrative authorities, the National Bank of Poland, the Social Insurance Office (ZUS), Societies, entities providing services to Funds as well as employers' associations, trade unions and other social organisations, within the scope of developing state policy and aiming to ensure the secure development of Funds and employee pension schemes;
- 7) providing the National Bank of Poland with information necessary for carrying out supervision of banks acting as depository banks and banks which are shareholders in Societies;
- 8) providing the Securities and Stock Exchange Commission with information necessary for carrying out supervision over the operations of the National Depository;
- 9) undertaking other activities provided for in this Act.

Article 201

1. There shall be a president of the Supervision Authority who shall be appointed by the President of the Council of Ministers for five year terms.

2. The President of the Council of Ministers may remove the President of Supervision Authority before the end of his term of office, after obtaining the consent of the Supervision Authority Advisory Committee referred to in Article 211 par. 1, expressed in the form of a resolution passed by an absolute majority of votes in the presence of at least two-thirds of the Committee members.

3. There shall be Deputy Presidents of the Supervision Authority who shall be appointed and removed by the President of the Council of Ministers at the motion of the Supervision Authority President. Deputy Presidents of the Supervision Authority may also be removed on the independent initiative of the President of the Council of Ministers.

4. The amount of funds to be used as remuneration of the President, Vice-Presidents, Director General and employees of the Supervision Authority shall be determined each year in a Budgetary Law, in relation to the salaries paid in Universal Societies, including bonuses and other benefits.

5. The Council of Ministers shall by ordinance confer a charter upon the Supervision Authority which shall specify its organisation and tasks.

Article 202

1. Proceedings before the Supervision Authority shall be conducted in accordance with the Code of Administrative Procedure, unless otherwise provided herein.

2. A decision of the Supervision Authority may be appealed against in the Supreme Administrative Court.

3. A request for re-examination of a case by the Supervision Authority shall not impede the execution of the Supervision Authority's decision to cancel a permit for the establishment of a Society, if the permit is cancelled due to reasons other than those defined in Article 61.

Article 203

1. The expenses of the Supervision Authority shall be borne from the State Budget in an amount specified annually in the Budgetary Law.

2. Universal Societies shall be charged with monthly fees representing no more than 0.02% of the contributions paid in a given month to the Open Funds governed by those societies.

3. Employee Societies shall be charged with quarterly fees representing no more than 0.2% of the contributions paid in a given quarter to the Employee Funds governed by those societies.

4. The employers operating employee pension schemes shall be charged with quarterly fees representing no more than 0.1% of the contributions paid in a given quarter in favour of participants of employee pension schemes.

5. Half of the proceeds from the fees referred to in par. 2-4 charged by the Supervision Authority shall constitute revenue of the special purpose fund of the Supervision Authority which shall be allocated for improving the work of the Supervision Authority, upgrading the professional qualifications of its employees and for paying bonuses to the President, Vice-Presidents, Director General and employees of the Supervision Authority. The remaining part of the proceeds shall constitute revenue of the state budget.

6. The detailed manner of allocating the proceeds constituting revenue of the special purpose fund and the principles for granting bonuses to employees of the Supervision Authority shall be determined by the President of the Supervision Authority in by-laws approved by the Supervision Authority Advisory Committee.

7. The principles for granting bonuses to the President, Vice-presidents and Director General of the Supervision Authority shall be determined in the statute referred to in Article 201 par. 5.

8. The Council of Ministers shall issue an ordinance defining the amount of, and procedure and dates for, paying the fees referred to in par. 2-4.

Article 204

1. Within the scope of its supervision over the activities of the Funds, the Supervision Authority shall in particular have the following rights and powers:

1) to request from the Society copies of all documents relating to the activities of the Fund and to become acquainted with their content,

2) to request any information or interview any members of the Board of Management, the Supervisory Board or any Employees of the Society regarding the activities of the Fund.

2. A person authorised by the Supervision Authority President shall have the right to enter the premises of:

1) a Society - for the purpose of verifying whether the activities of the Society conform with the law and its statute;

2) a Depositary - for the purpose of verifying whether its activities relating to the keeping of the Fund Assets conform with the law and the agreement on keeping the Fund Assets;

3) an entity entrusted with the keeping of the register of the Fund Members - for the purpose of verifying whether its activities relating to the keeping of the register conform with the law.

3. The person who conducts the inspection is entitled to:

1) inspect any books, documents and other records,

2) request copies of such documents and records to be made and released,

3) request any information from members of the statutory governing bodies and employees of the inspected entities.

4. A Society is under an obligation to ensure that the person who conducts the inspection is given access to all the

books, documents and other records relating to the activities of the Fund which are kept by third parties entrusted with some of the activities under separate agreements.

5. The scope of inspection shall be specified in the authorisation issued by the Supervision Authority President.

6. After the person conducting the inspection prepares an inspection protocol, the Supervision Authority shall notify the inspected entity of any irregularities discovered and fix the deadline for amending them.

7. Where irregularities have not been rectified within a deadline the Supervision Authority may impose on the inspected entity a penalty of up to PLN 500,000. Where there have been gross irregularities the Supervision Authority may impose the penalty immediately on them being discovered.

Article 205

1. A Member may make a complaint to the Supervision Authority against a Fund if the Member believes that the Fund's activity is not complying with applicable laws or provisions of the Fund's Statute.

2. A complaint may also be made by a person who has been a Member of the Fund during the six months preceding the making of the complaint.

3. A complaint may also be made to the Supervision Authority on behalf of a group of Members by a social organisation whose scope of tasks does not include the conducting of commercial activity.

Article 206

1. The Supervision Authority may demand the convening of statutory meetings of the Supervisory Board or Board of Management or a General Meeting of a Society and include such matters in the agendas of such bodies, as it feels are necessary in order to exercise proper supervision over the Fund.

2. In the cases referred to in para. 1 above, the Supervision Authority shall delegate its representative to participate in the meeting of the Supervisory Board or the Board of Management, or in the General Meeting of Shareholders, and such a representative shall be entitled to speak at the meeting in all matters included in the agenda.

Article 207

In civil matters relating to the establishment and operation of Funds, the Supervision Authority President shall have the rights of the Public Prosecutor, ensuing from the relevant provisions of the Code of Civil Procedure.

Article 208

The Supervision Authority President shall submit annual reports of the Supervision Authority activities to the President of the Council of Ministers.

Article 209

1. The Supervision Authority President, its Vice-presidents, Director General and employees may not hold shares in or be members of the Board of Management or Supervisory Board of a Society, or be bound to a Society by an employment or service contract or a similar legal relationship. This prohibition relates also to service contracts or similar legal relations between a Fund and the above specified persons.

2. The provisions of par. 1 above do not prejudice the provisions on restricting the possibilities of conducting commercial activities by persons occupying public positions.

Article 210

The provisions of Article 49 shall apply as appropriate to the Supervision Authority President, its Vice-Presidents, Director General and employees and to the persons who are bound with the Supervision Authority by a service contract or a similar legal relationship.

Article 211

1. The Supervision Authority Advisory Committee is hereby established as an advisory and consulting body of the Supervision Authority in matters relating to the operation of Funds and employee pension schemes.

2. The tasks of the Supervision Authority Advisory Committee will be to:

- 1) express opinions on draft normative acts regarding the operation of Funds and employee pension schemes,
- 2) express opinions on the reports on the Supervision Authority activities prepared by the Supervision Authority President,
- 3) present to the Supervision Authority opinions in matters relating to the operation of Funds and employee pension schemes,
- 4) give consent to the removal of the Supervision Authority President,
- 5) approve the by-laws referred to in Article 203 para. 6.

Article 212

1. The Advisory Committee shall consist of 15 members.

2. Members of the Supervision Authority Advisory Committee, including its Chairman and Vice-Chairman, shall be appointed by the President of the Council of Ministers from among individuals having the necessary knowledge and experience of matters relating to the activities of the Supervision Authority.

3. At least 6 members of the Supervision Authority Advisory Committee shall be appointed by the President of the Council of Ministers from among candidates proposed by the Trilateral Commission for Social and Economic Affairs.

4. The term of office of the Supervision Authority Advisory Committee members shall be six years from the date of appointment, with one-third of the Committee members being replaced every two years. Members of the Supervi-

sion Authority Advisory Committee shall perform their duties until the time their successors are appointed.

5. The Chairman and Vice-Chairman of the Supervision Authority Advisory Committee shall be nominated for two-year terms.

6. The provisions of Article 49 shall apply as appropriate to the Members of the Supervision Authority Advisory Committee.

7. The Supervision Authority President shall issue an ordinance specifying the principles for remunerating Members of the Supervision Authority Advisory Committee and the amount of their remuneration.

Article 213

The operating costs of the Supervision Authority Advisory Committee shall be covered from the State Budget.

Article 214

The working procedures of the Supervision Authority Advisory Committee shall be included in the by-laws adopted by the Supervision Authority Advisory Committee and approved by the President of the Council of Ministers.

A-3. The case of Bulgaria: Supplementary Voluntary Pension Insurance Act, passed on 7 July 1999 [fragments]

Chapter Three: Supervision and Licensing

Article 30.

1. For the purposes of licensing and supervision of the pension insurance companies involved in supplementary social security activities, including pension, health and unemployment insurance, the State Insurance Supervision Agency shall be established under the Council of Ministers.

2. The State Insurance Supervision Agency, hereinafter referred to as the Agency, shall be a legal entity funded by the budget and with head office in Sofia.

Article 31.

1. The budget of the Agency shall be approved on annual basis by the Council of Ministers, acting on proposal of the chairman of the Agency.

2. The revenue of the budget under para 1 shall include amounts which the agency collects for:

- 1) fees for license issuance;
- 2) fees for approval of amendments to the statute of the pension insurance company;
- 3) fines and property sanctions under Chapter Thirteen.

3. The fees, fines and property sanctions as referred to in paragraph 2 shall be determined by an act of the Council of Ministers.

Article 32.

The Council of Ministers shall adopt regulations for the application of this law and the Rules of Operation regulating the structure and functions of the Agency.

Article 33.

1. The management of the Agency shall be performed by its Chairman.

2. The chairman of the agency shall meet the requirements under Article 19.

3. A Supplementary Social Insurance Council shall be established under the Agency.

4. The Supplementary Social Insurance Council shall consist of seven members: the Minister of Labour and Social Policy, the Minister of Health Care, the Minister of Finance, the Minister of Justice and Legal Eurointegration, the Minister of the Interior, the Chairman of the Security and Stock Exchange Commission, and the chairman of the Agency. A representative of the Association of Supplementary Pension Insurance Companies shall also participate in the work of the Council with a deliberative vote.

5. Chairman of the Supplementary Social Insurance Council shall be the Minister of Labor and Social Policy who shall convene the Council and chair its meetings.

6. The members of the Council shall not be compensated for their activity as such.

7. The Supplementary Social Insurance Council shall make decisions on:

1) issuance and suspension of supplementary social insurance license within two months following the submission of the proposal by the Agency;

2) permission for merging, joining, separation, and division of supplementary pension insurance companies after submission of a permission for merging or joining by the Competition Protection Commission, when its issuance is mandatory;

3) initiation of bankruptcy proceedings for a supplementary pension insurance company;

4) approval of the list of depository banks in co-ordination with the Bulgarian National Bank, in accordance with this law.

8. The Council of Ministers shall adopt rules for the activity of the Supplementary Social Insurance Council.

9. The Council of Ministers shall appoint the chairman of the Agency and shall determine the number of staff for the agency.

Article 34.

The chairman of the Agency may not hold another salaried office nor is he/she entitled to a remuneration pursuant to a private contract except in cases of research or lecturing activities.

Article 35.

The Agency shall:

1) Issue and suspend licenses for supplementary social insurance activities;

2) Supervise the activity of the supplementary social insurance companies;

3) Register the Articles of Association and the Rules of Operation of the supplementary social insurance companies and their amendments;

4) Issue mandatory instructions for the elimination of violations of the Law and regulations related to supplementary pension insurance as well as for changes required in the Rules of Operation of the pension insurance companies;

5) Develop regulations on supplementary social insurance;

6) Impose measures for the financial rehabilitation of supplementary social insurance companies;

7) Submit to the court proposals for termination and liquidation of the supplementary social insurance companies in case of circumstances stipulated in this Act or other laws and regulations;

8) Prohibit the conclusion of new insurance contracts for a certain period of time;

9) Approve the list of the depository banks in co-ordination with the Bulgarian National Bank;

10) Approve upon co-ordination with the Institute of Certified Public Accountants the list of certified public accountants that are entitled to audit supplementary social insurance companies and voluntary pension funds;

11) Approve the biometric tables that may be used by supplementary social insurance companies and voluntary pension funds;

12) Establish and maintain its own information system and a register of the supplementary social insurance companies and voluntary pension funds;

13) Issue a periodic bulletin and other publications related to the performed activities.

Article 36.

1. For performance of its activities the Agency shall be entitled to:

1) require information, explanations and reports;

2) assign its officials to attend the meetings of the bodies of the supplementary social insurance companies when issues put forward by the Agency shall be discussed;

3) perform inspections of the depository banks jointly with the Bulgarian National Bank concerning deposits of the supplementary social insurance companies and funds.

2. In the execution of its activities the Agency shall be obliged:

1) To study in detail each complaint submitted by an insured person in a supplementary social insurance fund;

2) To issue mandatory prescriptions in case of justified complaints to the supplementary social insurance company for the purpose of elimination of the respective violation;

3) In case of occurrence of justified suspicions for a criminal offense during the investigation, to notify the prosecutor's office;

4) To keep the confidentiality of the information of supplementary social insurance companies and depositary banks.

3. When performing its supervisory functions the Agency and the persons authorised by it shall be liable for caused damages.

Article 37.

1. The authorised officials of the Agency when performing their official duties shall be entitled to free access to all business premises and to the documentation of the supplementary pension insurance companies and funds.

2. The Agency officials shall be obliged to keep the confidentiality of all information and data to which they have had access while performing their duties. Disclosure of such information shall only be done in the manner determined by the Agency.

Article 38.

1. The pension insurance company shall submit to the Agency a written application to obtain a license to engage in supplementary pension insurance activities, attaching the following documents:

1) A certified copy of the court decision on company registration;

2) The Articles of Association of the pension insurance company and all other documents related to the establishment of the company;

3) A bank certificate from the depositary banks or a court decision for the fully deposited capital under Article 14, para 3;

4) Estimates for the activity of the pension insurance company and the voluntary pension fund for the first three years, including income and expenditure estimates;

5) Actuarial projections for all offered pension schemes;

6) The full name and passport number of the actuary;

7) Documents, including declarations, proving compliance with the provisions of Article 19;

8) A list of the shareholders being in possession, directly or through related persons, of over 10% of the shares, or who are in a position to exercise control over the pension insurance company;

9) Samples of the insurance contracts;

10) Rules of the pension insurance company;

11) A report according to an approved model with respect to persons having inscribed for 1 per cent and over 1 per cent of the capital.

2. All entities under para 1, item 11 shall submit written declarations according to an approved model with respect

to the origin of the funds used to make contributions against inscribed shares and to the effect that the funds have not been borrowed and concerning the taxes paid by them in the last 5 years.

3. The Regional Court for the head office of the pension insurance company shall enter in the Commercial Register the company with sole activity pension insurance after submission of a license issued by the Agency.

Article 39.

1. The Agency shall declare its position on the application for a license as referred to in Article 17 not later than three months after the submission of the documents as referred to in Article 38.

2. The Agency shall notify the applicant in writing about its decision not later than 7 days after making the decision.

3. The license is issued for an unlimited period of time.

4. The decision for license issuance shall come into force upon its issuance and shall be promulgated in the State Gazette.

Article 40.

1. The Agency shall refuse to issue a license in case of non-compliance with the provisions of the Law.

2. In the cases described in paragraph 1 the Agency shall notify the applicant and shall determine a certain period of time, not less than two months, to eliminate discrepancies.

3. If the applicant fails to eliminate the discrepancies within the time limit determined in paragraph 2, the Agency shall refuse to issue a license by a motivated decision.

4. In case of refusal, the applicant may reapply for a license not earlier than 6 months since the date of coming into effect of the decision for refusal.

Article 41.

1. The Agency shall suspend the issued license on the basis of a substantiated decision when:

1) the information and data submitted for the purpose of a license issuance are false;

2) the pension insurance company fails to make or delays payments under the insurance contracts;

3) the mandatory provisions of the Agency are not being complied with;

4) the interests of the persons insured in the voluntary pension fund are exposed to a real and immediate threat;

5) the persons insured in the voluntary pension fund are less than 10,000 after the first two years from the date of licensing.

2. The Agency may provide an additional period for the cases as referred to in para 1, item 5, but not longer than for 6 months.

Article 42.

1. After suspension of the pension license, the pension insurance company may not enter into new contracts for

voluntary pension insurance and amend the conditions, including the period and amount of the contributions under contracts already concluded.

2. The Agency shall notify the court of registration of the company regarding the license suspension in order to cause the termination and commencement of liquidation procedure of the pension insurance company and shall promulgate the notice in the State Gazette.

3. Upon suspension of the license the Agency shall appoint a questor to control the pension insurance company's activities until the moment of appointment of a liquidator.

4. Suspension of a license shall not relieve the pension insurance company from its obligations under signed contracts.

5. The pension insurance company shall dispose with its property and with the assets of the voluntary pension fund after a written consent of the questor.

Article 43.

The resolutions of the Agency shall be subject to appeal to the Supreme Administrative Court in accordance with the provisions of the Administrative Proceedings Act.

A-4. The case of Lithuania: Pension Funds Act, passed in May 1999 [fragments]

Article 41. State Supervision of the Operations of Pension Funds

1. State supervision of the operations of pension funds shall be carried out by the Securities Commission. In pursuit of implementation of this Law the Securities Commission shall be entitled to issue legal acts within its terms of reference.

2. When issuing permits for pension funds and exercising supervision over their operations the Securities Commission shall carry out the following functions:

1) draft, approve changes of and acknowledge as invalid the rules that regulate issuing of permits for pension funds, management enterprises and depositories; as well as the establishing, restructuring, operations, reorganisation and liquidation of the pension funds;

2) draft, approve, change and acknowledge as invalid the formats of periodical reports of pension funds to the pension scheme participants, and establish procedures of submitting and publication of said documents;

3) provide official explanations and recommendations on all the issues of the pension fund activities;

4) issue and revoke operation permits for the pension funds and their management enterprises and restrict their operations;

5) monitor, analyse, inspect and supervise in other ways the operations of pension funds and pension fund management bodies;

6) set the rules for managing pension accounts;

7) apply the sanctions stipulated in the Republic of Lithuania Administrative Code to the heads of pension funds, management enterprises, depositories and auditors of said enterprises for violations of this law and other legal acts;

8) apply sanctions provided for in this and other laws to the persons who violate this law and the rules and instructions approved by the Securities Commission;

9) organise and carry out the inspections of the management enterprises and depositories;

10) carry out other functions established by this Law.

3. During the inspection officials of the Securities Commission have a right to:

1) receive explanations from the persons under investigation in relation to violations;

2) temporarily (up to 30 days) take with them documents of the inspected pension funds, their management enterprises and depositories that may be used as evidence of violations. When taking documents they must leave the motivated resolution regarding taking the documents and the description of taken documents;

3) request to make copies of the accounting documents, agreements and other documents which are considered by the Securities Commission as important for the inspection;

4) freely enter the premises of the pension funds, their management enterprises, and depositories; check accounting books, documents and other information sources needed for the check, provided they produce the service certificate and the resolution of the Securities Commission or its chairman;

5) to receive the data, certificates and copies of the documents about financial operations related with the object of investigation, if they provide the motivated resolution of the Securities Commission or its chairman.

4. The Securities Commission shall be entitled to appeal in court against persons who impede the implementation of the rights of the Securities Commission provided for in part 3 of this Article which are necessary to investigate the violations of the law. These cases are investigated by the District Court of Vilnius. Upon receipt of the request by the Securities Commission, within 24 hours the court must analyse it and issue a resolution obligating the person to perform actions requested by the Commission, abstain from actions impeding the investigation, or from rejecting the request of the Securities Commission. The Securities Commission shall not be charged the stamp duty for submitting the corresponding request. In the event the term allotted for investigating the case expires on a day-off the term shall be counted starting with the first working day following the day-off. Upon receiving the request, the copy thereof shall not be sent to the applicant, and the request to the court to submit

its opinion on the request is not submitted. The applicant shall be notified on the course of the case investigation. The request may also be expressed verbally. Participation of third persons, their representatives and other interested persons in the court session is not obligatory, and summons to them shall not be sent. The verdict arrived at by the District Court of Vilnius shall not be appealed and is effected from the moment the decision is passed.

5. Instructions of the Securities Commission to the pension funds, management enterprises, depositories or their managers regarding elimination of violations of the laws and other legal acts shall be binding.

6. Employees of the Securities Commission must ensure confidentiality of all the commercial secrets of which they had become aware when performing their duties. Employees shall be held responsible in accordance with the laws for using information not for the targeted purposes, or for other illegitimate actions.

7. The Ministry of Social Security and Labour shall monitor the compliance of pension schemes with requirements stipulated in this Law, control payment of benefits, protection of the rights of pension scheme participants when modifying the programs, and supervise the compliance of the pension agreements with collective and employment agreements.

8. Supervisory institutions envisaged in this law may request to carry out their orders, and shall be entitled to inspect, control or carry out investigations in order to ensure that pension funds, management enterprises or depositories comply with this Law and other legal acts and regulations related to it.

9. The Securities Commission shall have the right, following the procedure laid down in the Law on Legal Protection of Personal Data, to get access to the data of persons who are or intend to become managers of pension funds, management enterprises or depositories in order to make sure that the reputation of these persons is impeccable and that they are entitled to take such positions.

10. Pension funds may appeal in court against the decisions of the supervisory institutions stipulated in this Law.

Article 42. Consequences of Violating the Law

1. Economic entities that had violated this Law must:

1) fulfill the orders of the Securities Commission to terminate operations, restore the original situation, terminate or change agreements, fulfill other commitments;

2) compensate the damage;

3) implement the sanctions imposed by the Securities Commission.

2. The Securities Commission shall be entitled to impose monetary fines on:

1) economic entities operating as pension funds without the permit, stipulated in part 1 of Article 5. The size of the

fine may be as high as double the amount of illegitimately received income;

2) economic entities operating as pension fund management enterprises without the permit stipulated in part 1 of Article 7. The size of the fine may be as high as double the size of illegitimately received income;

3) pension funds that enter into pension agreements within the scope of pension schemes not registered with the Securities Commission. The size of the fine may be as high as 100,000 Lit.

3. Application of the sanctions stipulated in part 2 of this Article should not release the managers of economic entities from the civil, administrative and criminal responsibility provided by law.

4. The decision of the Securities Commission regarding imposing administrative fines may be appealed against in court following procedures set out in the laws of the Republic of Lithuania. Decisions of the Securities Commission regarding application of sanctions stipulated in part 2 of this Article may be appealed against in court within one month. The appeal shall not suspend the implementation of the orders or resolutions of the Securities Commission to eliminate violations of the laws or other legal acts, unless the court states otherwise.

5. Fines shall be paid to the budget no later than within one month of the date of receipt of the resolution to impose the fine upon the pension fund, management enterprise, depository or their managers.

6. In the event that within the period stipulated in the 5 of this Article the economic entity fails to pay the imposed fine and does not provide to the Securities Commission the verdict of the court to suspend or terminate the resolution on the fine, the fine shall be exacted from the income of the economic entity without the need to bring a case.

7. Within one month from the date of receipt of the resolution of the Securities Commission the economic entities may appeal in court regarding revocation or amendment of the said resolution.

8. The court appeal shall not suspend the implementation of the orders and resolutions of the Securities Commission, unless the court advises otherwise.

A-5. The case of Estonia: Pension Funds Act, passed on 10 June 1998 (RT * I 1998, 61,979) [fragments]

Introductory remarks

The reform of the current pay-as-you-go pension system in Estonia, which started in 1997, is part of a wide programme of structural reforms. The goal of the reform is to create a new three-tier pension system by the year 2002 (Ministry of Finance, 1999).

The first pillar is the state pension, operating as a compulsory system, based on current financing from social security contributions (pay-as-you-go system). The second pillar, similar to the Hungarian and Polish models, is planned as the mandatory funded pension, managed by the private sector. Employees will make mandatory contributions of a defined sum into the pension funds created. The third pillar is a completely voluntary pension, administered either by life insurance companies with a special licence or managing companies (OECD 1999).

Pension funds, operating as voluntary institutions, exist in Estonia since 1992. However, they were only regularised from the legal point of view at a later date, by the Act regarding Voluntary Pension Funds. In order to stimulate voluntary savings for old age, the government introduced tax allowances for those who participate in such programmes. Employees are entitled to deduct voluntary contributions up to 15% of their income. Within this tier, insurance companies dominate, constituting more than 70% of the contracts.

The Pension Funds Act, which regulates the functioning of pension funds within the second pillar, came into effect 1 August 1998. This act functions under the Act on Investment Funds. In July of 1999, the government made the first decisions regarding the principles of implementing the second pillar. In March 1999, at the proposal of the Finance Ministry's licensing commission, the first licence for the management of pension fund was issued.

According to the Pension Funds Act, the role of the supervisory institution is assigned to the Ministry of Finance. In this regard, the case of Estonian pension reform resembles the model applied in Lithuania, where similarly a separate, independent supervisory institution has not been chosen.

Chapter 2

§ 5. Activity licence

1. Activity licences for the management of pension funds (hereinafter activity licences) are issued and revoked by a directive of the Minister of Finance. Upon refusal to issue an activity licence or revocation of a licence, the justification shall be indicated in the directive.

2. The committee provided for in subsection 19 (4) of the Investment Funds Act shall make proposals to the Minister of Finance regarding the issue and revocation of activity licences, the grant of the deadline specified in subsection 10 (2) of this Act, and the request for additional information from applicants pursuant to subsection 8 (2) of this Act.

3. Activity licences are issued for an unspecified term.

4. An activity licence is not transferable, and its acquisition or use by other persons is prohibited.

§ 6. Application for activity licence

1. An activity licence for management of a pension fund may only be applied for by a management company which, at the time of application, has been operating as a management company for at least eighteen months and which has managed a contractual investment fund during the last twelve months.

2. In order to apply for an activity licence, the management board of a management company shall submit the following documents and information to the Securities Inspectorate:

1) an application to obtain a pension management company activity licence and to register the pension fund rules;

2) the resolution of the general meeting on amendment of the articles of association;

3) an extract from the registry card of the commercial register;

4) the last approved annual report;

5) the balance sheet and income statement as at the end of the month prior to submission of the application if, upon submission of the application, more than seven months have passed since the end of the financial year;

6) an activity report which contains all material information and an analysis of the activities and development of the management company to date as at the last day of the month prior to submission of the application;

7) the last approved annual or half-yearly reports of the investment funds managed, and a statement of investments which is compiled as at the end of the last working day of the month prior to submission;

8) statements, which upon submission of the application shall not be more than ten days old, from the local Tax Board Office certifying the absence of tax arrears

of the management company and the legal persons specified in clause 13) of this subsection;

9) information on the members of the management board and supervisory board of the management company which sets out each member's given name and surname, personal identification code or date of birth in the absence of a personal identification code, residence, educational background, and a complete list of places of employment and positions held during the last five years;

10) the information specified in clause 9) of this subsection on other members of the management of the management company (managing director, chief accountant etc.) and the persons who conduct the internal audits;

11) information on the procurator and auditor of the management company which sets out the given name and surname, residence and personal identification code or date of birth in the absence of a personal identification code of each;

12) information on the shareholders of the management company which sets out the name, registry code, or personal identification code or date of birth in the absence of a

personal identification code, and the number of shares and votes of each shareholder;

13) information on shareholders who directly or indirectly or together with undertakings belonging to the same group of companies hold more than 10 per cent of the share capital or of the votes represented by shares of the management company; in the case of a legal person, the name, registry code, and annual accounts for the previous financial year, and the given names, surnames and personal identification codes or dates of birth in the absence of a personal identification code of the members of the management board or of the body substituting for the management board, and of the supervisory board upon the existence of a supervisory board; in the case of a natural person, the information specified in clause 9) of this subsection;

14) information on companies in which the holding of the management company, a member of its management board or supervisory board, the procurator, the fund manager specified in clause 17) of this subsection, or of the above-mentioned persons combined, is greater than 10 per cent; this information shall also include the amount of share capital, a list of the areas of activity and the percentage of holding of the above-mentioned persons;

15) the resolution to establish the pension fund;

16) a three-year business plan;

17) information on the fund manager of the pension fund which sets out the information specified in clause 9) of this subsection, and a detailed overview of the investment funds managed by him or her (including the value of the assets, the rate of return, the dynamics of the structure of investments, and a complete overview of precepts issued, of compliance with such precepts and of cases specified in §§ 45 and 49 of the Investment Funds Act);

18) the pension fund rules;

19) the pension fund prospectus;

20) a depositary contract specified in § 86 of the Investment Funds Act;

21) the annual accounts of the depositary for the previous financial year;

22) the given names, surnames and personal identification codes or dates of birth in the absence of a personal identification code of the members of the supervisory board and management board, and of the procurator and auditor of the depositary;

23) information on the shareholders of the depositary who hold more than 5 per cent of the votes represented by shares; the information shall set out the name, registry code, or personal identification code or date of birth in the absence of a personal identification code, and the number of shares and votes of each shareholder;

24) an overview of the activities of the depositary to date as a depositary for investment funds;

25) proof of payment of the state fee.

3. The report specified in clause (2) 6) of this section shall, among other matters, set out a description and analy-

sis of the following information:

1) the amount of share capital and shareholders' equity;

2) changes in the investment policy of the investment funds managed;

3) the market value, net asset value, rate of return of the assets and structure of investments of the investment funds managed;

4) the number of units which have been issued and the number of units which have been redeemed;

5) the number of unit-holders who are natural persons and their proportion in the investment funds managed by the applicant;

6) the amount of management fees, depositary's charges and other expenses incurred on behalf of the investment funds;

7) the management structure of the management company, the organisational and technical administration of its activities, and the rights, obligations and liability of persons involved in the management of investment funds.

4. The business plan specified in clause (2) 16) of this section (hereinafter business plan) shall set out a forecast and analysis of all the important economic indicators of the pension fund and the pension management company, and the rights, obligations and liability of persons involved in the management structure of the management company and in the management of the pension fund, and also a description, forecast and analysis of the following factors:

1) the number of units to be issued and the number of units to be redeemed;

2) the organisation of the issue of units;

3) the number of unit-holders;

4) the market value, net asset value and rate of return of the assets of the pension fund;

5) the investment policy and structure of investments of the pension fund (divided by different asset classes - shares, debt instruments, immovable property, etc.,

issued by issuers of different countries, by different sectors of the economy, etc.);

6) risks and rate of return by the different types of investment;

7) the share capital, balance sheet total and profit of the pension management company;

8) the rates for and amount of proceeds from management fees, depositary's charges, and the issue and redemption fees of units;

9) the amount and structure of the management expenses of the pension fund;

10) the development of the organisational structure and technical administration of the pension management company.

5. At the request of the Securities Inspectorate, a management company is required to submit more specific information and documents concerning information

subject to submission.

6. The Minister of Finance may establish the procedure

for submission of the information specified in subsection (2) of this section.

7. If a management company fails to submit all the information and documents specified in subsection 2 if this section, or if the information or documents are incorrect, incomplete or incorrectly prepared, or do not comply with the requirements established by legislation, the Securities Inspectorate shall inform the applicant thereof in writing. The applicant shall eliminate the deficiencies within twenty calendar days after receipt of such notice.

§ 7. Refusal to issue activity licence

1. Issue of an activity licence shall be refused if:

1) the applicant for an activity licence fails to submit all the information and documents specified in § 6 of this Act, or such information or documents are incorrect, incomplete or incorrectly prepared, or do not comply with the requirements provided by legislation;

2) the applicant does not comply with the requirements established for pension management companies by legislation;

3) the applicant has violated provisions of legislation, the rules or articles of association of the investment fund, or the management contract specified in § 72 of the Investment Funds Act, or has provided misleading information to the public or violated good business practices in some other way;

4) the applicant does not have the necessary funds or experience to operate as a pension management company with success and continuity;

5) the persons specified in clauses 6 (2) 9), 10), 13) and 17) of this Act do not comply with the requirements provided by legislation;

6) the knowledge, skills, experience and other capabilities and characteristics of the persons referred to in clause 5) of this subsection are not adequate to ensure sufficient protection of the interests of the unit-holders of the pension fund;

7) the pension fund rules do not reflect all the essential rules of the operation of a pension fund in full, clearly and unambiguously, or contain provisions which are misleading or contradictory, or the pension fund rules do not ensure promotion of the best interests of the unit-holders of the pension fund;

8) the investment policy proposed in the rules and business plan of the pension fund does not ensure adequate risk-spreading, or the necessary reliability and sustainable growth of the assets of the pension fund;

9) the business plan submitted is incomplete, contains contradicting and inadequate information or assessments, or upon implementation would not be adequate to ensure protection of the interests of the unit-holders of the pension fund;

10) the depositary does not comply with the requirements established for depositaries of pension funds pursuant to law;

11) the depositary has violated provisions of Acts, other legislation, the rules or articles of association of the investment fund, or the depositary contract;

12) the depositary contract contains provisions which are contradictory, ambiguous, or which prevent the depositary or pension management company from performing their duties in full, or which for some other reason do not enable promotion of the best interests of the unit-holders of the pension fund;

13) the applicant or the persons specified in clause 5) of this subsection are not sufficiently reliable nor capable to the necessary extent of ensuring promotion of the interests of the unit-holders of the pension fund.

2. Among other matters, the following shall be considered upon assessment of the provisions of clause (1) 4) of this section:

1) the level of the organisational and technical administration of the activities of the applicant;

2) the professional qualifications and experience of persons engaged in the management of investment funds, and transparency of their rights, obligations and liability;

3) the value, rate of return and sustainability of growth of the assets of the investment funds managed by the applicant;

4) the number of unit-holders who are natural persons and their proportion in the investment funds managed by the applicant;

5) the level of risk-spreading, and experience in making different types of investments (shares, debt instruments, immovables, derivative instruments, issuers from different countries, different sectors of the economy).

§ 8. Decision to issue activity licence

1. The Minister of Finance shall decide to issue or refuse to issue an activity licence within ninety days after submission of an application and the information specified in subsection 6 (2) of this Act to the Securities Inspectorate by an applicant.

2. In order that a decision be made, the management company, depositary and Securities Inspectorate are required to submit additional documents and information at the request of the Minister of Finance. The Minister of Finance shall issue a directive to request additional documents and information.

3. The following shall be indicated on an activity licence:

1) the number of the activity licence;

2) the name and commercial registry code of the pension management company;

3) the area of activity permitted by the activity licence;

4) the date of issue of the activity licence;

5) the issuer of the activity licence.

4. An activity licence, a copy of the directive of the Minister of Finance to issue or refuse to issue the activity licence, and a copy of directives specified in subsection (2)

of this section and subsection 20 (3) of this Act shall be sent to the applicant within three working days after the issue of such directive.

§ 9. Termination of activity licence

An activity licence terminates:

- 1) upon expiry of the term of validity of the activity licence issued to a pension management company for the management of investment funds;
- 2) four months after issue of the activity licence if the management company has not commenced issue of the units of the pension fund;
- 3) upon transfer of the management of a pension fund, if as a result the pension management company no longer manages any pension funds;
- 4) upon revocation of the activity licence.

§ 10. Revocation of activity licence

1. An activity licence shall be revoked if:

- 1) it becomes evident that information submitted upon application for the activity licence which was of material importance in the decision to issue the activity licence is false; also in cases where false information has been submitted to the Minister of Finance or the Securities Inspectorate, or upon repeated failure to submit information on time;
 - 2) the pension management company or the persons specified in clauses 6 (2) 9), 10), 13) and 17) of this Act do not comply with the requirements provided by legislation;
 - 3) the pension management company has in the course of its activities violated provisions of legislation or the pension fund rules, or if the interests of the unit-holders of the pension fund have been harmed by the violation;
 - 4) the pension management company provided materially incorrect or misleading information or advertising concerning its activities, the members of its directing bodies, or its shareholders to the public;
 - 5) the pension management company has failed to implement a precept of the Securities Inspectorate for the specified term or to the extent prescribed;
 - 6) the circumstances specified in clauses 7 (1) 3), 4), 6) or 13) of this Act become evident.
2. Prior to a decision to revoke an activity licence, the Minister of Finance, by a directive, may grant a pension

management company a term for elimination of deficiencies which are the basis for revocation.

3. A copy of the directive of the Minister of Finance by which an activity licence is revoked or the term specified in subsection (2) of this section is determined shall be promptly sent to the person specified in the directive and to the depositary of the pension fund managed by the person.

§ 20. Amendment of pension fund rules

1. The permission of the Minister of Finance is required for amendment of pension fund rules.

2. In addition to the provisions of subsection 36 (3) of the Investment Funds Act, a justification and analysis of the effects of the amendments on the further development of the pension fund and on the interests of the unit-holders of the pension fund, and the position of the management board of the depositary concerning the amendments to the pension fund rules, shall be submitted in order to amend pension fund rules. Upon entry into a new depositary contract, the information specified in clauses 6 (2) 21)-24) of this Act shall also be submitted.

3. The Minister of Finance shall decide to grant or refuse to grant the permission specified in subsection 1 of this section by issuing a directive within forty days after submission of a corresponding application and the prescribed information to the Securities Inspectorate by the applicant.

4. The permission specified in subsection (1) of this section shall be refused if the amendments to the pension fund rules would harm the interests of the unit-holders of the pension fund or if other circumstances specified in subsection 7 (1) of this Act become evident.

§ 38. Investment in deposits

1. Assets of a pension fund may only be invested in the deposits of credit institutions located in Estonia, the European Union or states entered on a list approved by the Minister of Finance.

2. The assets of a pension fund invested in the deposits of a credit institution shall total not more than 20 per cent of the market value of the assets of the pension fund.

3. The assets of a pension fund deposited in a single credit institution shall total not more than 5 per cent of the market value of the assets of the pension fund.

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